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IN THE

Supreme Court of the United States

OCTOBER TERM, 2002

CAREY D. EBERT, AS TRUSTEE IN BANKRUPTCY FOR GRAVITY, INC., and MARK H. DICKSON,

Petitioners,

—*v.*—

MICROSOFT CORPORATION, COMPAQ COMPUTER CORPORATION, DELL COMPUTER CORPORATION, and PB ELECTRONICS, INC. (F/K/A/ PACKARD BELL NEC, INC.),

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

MICROSOFT CORPORATION'S BRIEF IN OPPOSITION

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Questions Presented

In *Illinois Brick Co.* v. *Illinois*, 431 U.S. 720 (1977), this Court held that indirect purchasers have no claim for damages under the federal antitrust laws, and suggested only two possible exceptions to that rule. Gravity concedes that it acquired Microsoft's software only by purchasing a personal computer ("PC") from a manufacturer that had preinstalled that software—*i.e.*, that it is an indirect purchaser of software—and that neither suggested exception to *Illinois Brick* applies here. Instead, Gravity asserts that because it alleged that manufacturers of the purchased PCs conspired to give Microsoft (their supplier) monopoly power in certain *software* markets, *Illinois Brick* is inapplicable.

The questions presented for review are:

1. Did the Fourth Circuit correctly affirm dismissal of Gravity's damages claims under the indirect-purchaser rule of *Illinois Brick*?

2. Did the Fourth Circuit correctly affirm dismissal of Gravity's antitrust conspiracy claims given its failure to allege harm to competition?*

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* As in the proceedings below, Microsoft primarily addresses herein the *Illinois Brick* issues, while the other respondents address in greater detail Gravity's failure to plead an actionable Sherman Act conspiracy claim.

Rule 29.6 Corporate Disclosure Statement

Microsoft Corporation has no corporate parents, and no publicly held company owns 10% or more of Microsoft Corporation's stock.

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MICROSOFT CORPORATION'S BRIEF IN OPPOSITION

This Court should deny the petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fourth Circuit in this case. That court's application of *Illinois Brick* is entirely consistent with the decisions from the three other circuits to which Gravity points. Indeed, the Fourth Circuit carefully analyzed the decisions from those other circuit courts and properly concluded that they all involve a "narrow" situation—price fixing between the manufacturer and direct purchaser—that concededly is not at issue here. (App. 30a) There is no conflict among the circuits on the proper application of *Illinois Brick* to the facts of this action.

The Fourth Circuit's judgment is not only consistent with *Illinois Brick* but compelled by it. The petition for certiorari should be denied.

Statement of the Case

A. Background.

In 1998, the United States and certain States brought actions alleging that Microsoft had improperly maintained a monopoly in a market for operating-system software by engaging in certain conduct directed at competitors or potential competitors. The government actions never alleged that consumers were overcharged for Microsoft software. Subsequently, about 140 putative class actions were filed in state and federal courts around the country by private parties alleging that end-users had been overcharged for Microsoft software and seeking damages for those alleged overcharges. Most of these actions were filed in state courts invoking state laws that permit indirect purchasers to recover damages.

The Judicial Panel on Multidistrict Litigation transferred this and approximately 60 other federal-court actions against Microsoft to the District of Maryland. The JPML has also transferred to that district court a putative class action brought on behalf of those that purchased software directly from Microsoft for resale, including computer manufacturers (also called original equipment manufacturers or OEMs).

Of all these cases brought against Microsoft, this is the only one in which any plaintiff has sued any OEM alleging an antitrust "conspiracy" among OEMs and Microsoft. Indeed, the same lawyers who brought this action also filed—almost simultaneously—a nearly identical action in California state court under California state law (which permits indirect-purchaser actions) in which Microsoft is the sole defendant.

B. Gravity's Allegations.

Gravity concedes it did not purchase software or anything else from Microsoft. Instead, Gravity acquired Microsoft software by purchasing a PC on which an OEM had preinstalled Microsoft software. Thus, Gravity never directly

purchased software—the subject of the alleged conspiracy—from Microsoft or anyone else.

According to Gravity, the OEM defendants conspired with Microsoft to allow Microsoft to monopolize certain software markets and then to charge the OEM defendants—the direct purchasers of the software—monopoly prices. The OEMs then allegedly passed on the overcharges to Gravity in the form of higher prices for PCs. The three OEM defendants allegedly benefited from this peculiar scheme (which gave their supplier monopoly power over an important input) by obtaining more favorable treatment from Microsoft than other unidentified OEMs. Gravity never alleged that Microsoft and the OEM defendants conspired to fix prices of either software or PCs.

Gravity's petition fails to mention a key concession explicitly relied upon by both the district and circuit court. (App. 18a, 59a) In the proceedings below, Gravity conceded that PC prices are set in a "hyper-competitive" market. (C.A. App. 561, 555) There is no allegation that PCs (the product Gravity purchased) were the subject of any conspiracy.

C. The District Court's Decisions.

In January 2001, in the actions brought by end-users, the district court—applying *Illinois Brick*'s bright-line rule precluding indirect purchasers from recovering damages under federal antitrust law—dismissed the damages claims of indirect purchasers. *In re Microsoft Corp. Antitrust Litig.*, 127 F. Supp. 2d 702, 708-13 (D. Md. 2001). At the same time, the court dismissed under Fed. R. Civ. P. 12(b)(6) Gravity's conspiracy claims on the ground that Gravity had failed to allege that the OEM defendants had either the motive or power to enhance Microsoft's market position. (App. 46a) Though the parties had briefed the issue, the district court did not then reach the issue of whether *Illinois Brick* also barred Gravity's damages claims. (App. 55a)

In February 2001, Gravity sought leave to file an amended complaint under Fed. R. Civ. P. 15(a). The court denied that motion in September 2001 on grounds of futility, concluding that the proposed amendments did not cure Gravity's failure to allege a valid conspiracy claim. (App. 60a) In addition, the district court then concluded that, as an indirect purchaser of Microsoft software, Gravity's claims for damages were barred by *Illinois Brick*. (App. 64a)

D. The Court of Appeals' Decision.

The Fourth Circuit affirmed on both grounds in October 2002, in a 2-1 decision. With respect to whether a valid antitrust conspiracy had been alleged, the court held that Gravity had failed to allege that the conspiracy enhanced Microsoft's alleged market power in "ways that would not have obtained absent the agreement." (App. 21a) As to the district court's application of the indirect-purchaser rule, the Fourth Circuit concluded that the two primary rationales for the *Illinois Brick* rule—precluding "multiple, 'overlapping recoveries' against the original seller by direct and indirect purchasers" and avoiding "the 'evidentiary complexities and uncertainties' in determining the amount of any overcharge passed through the intermediary to the indirect purchaser"—applied with full force to Gravity's allegations here. (App. 29a (quoting *Illinois Brick*, 431 U.S. at 730, 732))

The Fourth Circuit also considered Gravity's contention that "*Illinois Brick* is inapplicable" because Gravity had purchased from an alleged co-conspirator. (App. 30a) After reviewing the decisions applying a so-called "co-conspirator" exception, however, the court concluded that those decisions all involved "price-fixing conspiracies," and it rejected Gravity's argument that the exception should be expanded beyond that "narrow" circumstance. (App. 30a) Otherwise, even "to the extent a court were to recognize a co-conspirator exception," the "*Illinois Brick* rule would be inverted solely based upon artful pleading." (App. 30a)

In November 2002, Gravity petitioned for rehearing and rehearing en banc. Both were denied on December 19, 2002. No judge requested a poll on the petition for rehearing en banc. (App. 65a)

Reasons For Denying the Petition

I.

Illinois Brick Bars Gravity's Damages Claims.

Illinois Brick involved an action brought by the State of Illinois against concrete block manufacturers that allegedly conspired to fix the price of concrete blocks. The manufacturers sold their concrete blocks to contractors, who incorporated the blocks into buildings purchased by Illinois. The manufacturers allegedly overcharged the contractors who, in turn, "passed on" the overcharge to Illinois. This Court rejected Illinois's claims and set forth the bright-line rule that only direct purchasers—those who purchased the product that was the subject of the alleged anticompetitive conduct directly from the alleged antitrust violator—can recover damages under federal antitrust law.

As the Fourth Circuit observed, Gravity's claims are "materially indistinguishable from the claim under consideration in *Illinois Brick*." (App. 31a) Gravity's claim that it paid too much for a PC containing software for which an OEM was allegedly overcharged is no different from Illinois's claim that it paid too much for buildings containing blocks for which a contractor was allegedly overcharged.

Despite this Court's admonition that "even assuming that any economic assumptions underlying the *Illinois Brick* rule might be disproved in a specific case, we think it an unwarranted and counterproductive exercise to litigate a series of exceptions," *Kansas* v. *UtiliCorp United Inc.*, 497 U.S. 199, 217 (1990), some courts have held that *Illinois Brick* does not apply where indirect purchasers allege an illegal vertical conspiracy whose object was to fix the price

of the product purchased by plaintiff. As the Fourth Circuit noted, this "co-conspirator" exception has never been applied by this Court, and it conflicts with this Court's observation in *UtiliCorp* that further exceptions to *Illinois Brick* "would undermine the rule." 497 U.S. at 216. Indeed, the dramatically expanded version of the co-conspirator exception urged by Gravity would swallow the rule whole.

Most importantly, as the Fourth Circuit recognized, the "co-conspirator" exception, even if it exists, is not at issue in this action. The decisions applying the exception have all arisen in the "narrow" situation where a plaintiff purchases a product whose price was set by a "price-fixing conspiracy." (App. 30a) This is because there is no need to engage in a pass-through analysis where the conspiracy's object was "the very price paid by the consumer." 2 PHILLIP E. AREEDA ET AL., ANTITRUST LAW ¶ 346h, at 369 (2d ed. 2000).[1]

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[1] The very cases relied upon by Gravity (i) demonstrate that this so-called exception is limited to price-fixing conspiracies and (ii) expose Gravity's false claim that the Fourth Circuit's application of *Illinois Brick* "conflicts with precedent from three circuits." (Pet. at 21 (capitalization omitted)) *See Paper Sys. Inc.* v. *Nippon Paper Indus. Co.*, 281 F.3d 629, 631 (7th Cir. 2002) ("conspir[ed] to . . . raise price"); *Lowell* v. *Am. Cyanamid Co.*, 177 F.3d 1228, 1229 (11th Cir. 1999) ("vertical price-fixing conspiracy"); *In re Brand Name Prescription Drugs Antitrust Litig.*, 123 F.3d 599, 606 (7th Cir. 1997) ("price-fixing conspiracy"); *Arizona* v. *Shamrock Foods Co.*, 729 F.2d 1208, 1210 (9th Cir. 1984) ("wholesale price-fixing conspiracy").

In a further attempt to invent a conflict among circuits, Gravity incorrectly asserts that the Seventh Circuit has applied the co-conspirator exception to a conspiracy that did not involve price-fixing. (Pet. at 22) In *Fontana Aviation, Inc.* v. *Cessna Aircraft Co.*, 617 F.2d 478, 481 (7th Cir. 1980), the court found *Illinois Brick* inapplicable because plaintiff, as a *competitor* of the alleged antitrust violator, pleaded "competitive injury which destroyed its . . . business." The Third Circuit has noted this distinction as well. *See Link* v. *Mercedes-Benz of N. Am., Inc.*, 788 F.2d 918, 931 n.11 (3d Cir. 1986) (*Fontana* concerns competitive injuries "distinct from a passed on overcharge").

But Gravity has not alleged that Microsoft and the OEM defendants conspired to fix the price of either software or PCs. Indeed, it conceded that prices for PCs—the only product Gravity alleges to have purchased—are set in a highly competitive market. Gravity's failure to allege a conspiracy to set the resale price of PCs makes the "co-conspirator" exception inapplicable. Accordingly, the Fourth Circuit's decision that Gravity's damages claims are barred falls squarely within this Court's holding in *Illinois Brick*.

In the end, Gravity's petition implicitly recognizes the absence of a genuine conflict among the circuits and devotes the majority of its discussion of the Fourth Circuit's *Illinois Brick* holding to broad policy attacks against the application of the indirect-purchaser rule. (Pet. at 23-28) Echoing the circuit court dissent's assertion that "*Illinois Brick* might . . . require dismissal of Gravity's claims" if the defendant OEMs "switched sides and sued Microsoft" (App. 44a n.2), Gravity asserts that the indirect-purchaser rule should not be applied here because OEMs have not sued Microsoft. (Pet. at 28) This is incorrect—an alleged class of OEMs is present in one of the pending cases in the trial court—but also irrelevant.

This Court rejected Gravity's argument in *Illinois Brick* itself. While expressly acknowledging that direct purchasers "sometimes may refrain from bringing a treble-damages suit for fear of disrupting relations with their suppliers," the Court nonetheless concluded that the deterrence goals of the antitrust laws were best served by concentrating the right of recovery on direct purchasers:

> [O]n balance, and until there are clear directions from Congress to the contrary, we conclude that the legislative purpose in creating a group of "'private attorneys general'" to enforce the antitrust laws under § 4 is better served by holding direct purchasers to be injured to the full extent of the overcharge paid by

> them than by attempting to apportion the overcharge among all that may have absorbed a part of it.

431 U.S. at 746 (citation omitted).

As the Fourth Circuit recognized, Gravity's policy arguments are "virtually identical" to those raised in Justice Brennan's *Illinois Brick* dissent. (App. 32a)[2]

II.

Gravity Has Failed to State a Cognizable Antitrust Conspiracy Claim.

Finally, as discussed more fully in the OEM defendants' brief, the Fourth Circuit correctly concluded that Gravity's conspiracy allegations, forced into the complaint in an attempt to evade *Illinois Brick*, fail to state a claim upon which relief can be granted. Gravity's assertion that the Fourth Circuit improperly applied a heightened pleading standard to dismiss Gravity's claims is wrong. An antitrust plaintiff must make allegations that, taken as true, demonstrate harm to competition. *See, e.g., NYNEX Corp.* v. *Discon, Inc.*, 525 U.S. 128, 140 (1998) (complaint that fails to allege "harm to the competitive process" subject to dismissal). Because Gravity conceded that the market for PCs was "'fiercely competitive,'" the Fourth Circuit properly concluded that Gravity had failed to plead facts showing that Microsoft's agreements with the OEM defendants "are capable of causing any substantial harm to competition." (App. 18a)

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[2] This is also not a case where the direct purchasers (OEMs) are owned or controlled by the alleged antitrust violator. *See Freeman* v. *San Diego Ass'n of Realtors*, No. 01-56199, 2003 WL 931834, at *6 (9th Cir. Mar. 10, 2003) (*Illinois Brick* inapplicable to price-fixing conspiracy where direct purchaser was "own[ed]" by antitrust violators); 2 AREEDA ET AL., ANTITRUST LAW ¶ 346f, at 367 (courts may allow indirect-purchaser recovery when "direct purchasers [are] owned or controlled by the *violator*").

Finally, although it expressed disagreement with the Sixth and Eighth Circuits' application of this Court's precedent in the course of addressing Gravity's conspiracy claims, the Fourth Circuit expressly noted that its holding was "unaffected" by that disagreement. (App. 11a n.13) Just as the Fourth Circuit's application of *Illinois Brick* involves no genuine conflict, no conflict justifying a grant of certiorari exists regarding the Fourth Circuit's conspiracy holding either.

Conclusion

The Court should deny the petition for a writ of certiorari.

Respectfully submitted,

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